

NOTES

1. *The Nation's Housing: 1975-1985* (Cambridge, Mass.: Joint Center for Urban Studies—Harvard—MIT, February 1977).

2. *Homeownership: The Changing Relationship of Costs and Incomes, and Possible Federal Roles* (Washington, D.C.: Congressional Budget Office, January, 1977). See also: Hearings Before the Subcommittee on Housing and Urban Affairs on the Development of New Types of Home Mortgage Instruments, Both FHA-Insured and Conventionally Financed, August 4, 9, 10, 1976 (Washington, D.C.: U.S. Government Printing Office, 1976).

3. Franco Modigliani and Donald Lessard, *New Mortgage Designs for Stable Housing in an Inflationary Environment* (Boston, Mass.: Federal Reserve Bank of Boston, Conference Series No. 14).

4. Letter from H.L. Tadman, Chief Financial Institutions, Capital Markets Divisions, Department of Finance, Canada.

Comment

by

James B. Burnham

Before commenting on Professor Rosen's two interesting proposals—for an "equity-adjusted mortgage" and "individual housing accounts"—I feel justified in making a few observations on his extensive opening section regarding the "housing crisis."

So far as I have been able to determine, this country has been in a constant "housing crisis" since at least the 1930s. No survey of the literature on housing policies, costs, or technology can fail to uncover repeated references to this alleged condition. While initially the crisis was defined in terms of physical inadequacy and overcrowding, it has now become fashionable to cite "excessive cost" and "inadequate neighborhood environment" as the chief elements in the crisis. The reason for this shift in definition is clear: by admittedly rough measures of minimal physical adequacy and overcrowding, the crisis as a national social problem has all but disappeared. However, by shifting standards and definitions regarding "acceptable" housing-income-neighborhood relationships, it has been possible to perpetuate the "housing crisis" syndrome, of which Professor Rosen's opening paragraphs are a classic example.

But let me turn to the immediate issue at hand: the cost of homeownership. Clearly the increase in the cost of owning a home over the

past thirty-five years has not been rapid enough to prevent the United States from becoming a nation of homeowners. Between 1940 and 1970 the percentage of owner-occupied units in the housing stock rose from 43.6 percent to 62.9 percent. And in 1974 that proportion reached a record of 64.6 percent, despite a rapid acceleration in the cost trends for both new and previously occupied housing.

While it is true that most trend analyses of housing costs which use the 1970-75 period—as the Congressional Budget Office and Harvard-MIT Joint Center studies do—can point to a significant deterioration in the housing cost-income relationship, other studies over a longer period of time and including 1967-73—such as that by Weicher and Simonson—arrive at the reverse conclusion.¹ But even if the housing cost-income relationship has conclusively deteriorated in recent years, this provides no *de facto* grounds for proclaiming a national emergency. To begin with, nearly all consumer cost-income relationships deteriorated significantly in the 1973-75 period, a result of the severe recession and unprecedented general inflationary pressures.

Second, trends in personal income and homeownership costs over the period 1976-I to 1977-I show an abrupt reversal of 1973-75 patterns. At the same time, there has been a record-breaking surge of activity in both the single-family new construction and resale markets. Despite mortgage interest rates and down payment requirements on newly built homes which differ little from those in 1975, single-family homebuilding and sales may well set new all-time records in 1977. Finally, Professor Rosen suggests that "homeownership is becoming available only to the fortunate few. . . . This of course excludes most low- and middle-income households, most minority households, and most young families." Does this mean that these groups are less able to afford homeownership today than they could ten years ago? Or does the statement refer to cost-income developments on the downside of the 1973-75 business cycle that affected nearly *all* families? Such a sweeping and politically charged statement should be fully supported by references to documented trends in the characteristics of homeownership households.

Turning now to Professor Rosen's two proposals, I should start by indicating my sympathy with the concept of permitting lending institutions to experiment with a wide variety of mortgage instruments. It is abundantly clear that high and/or rising rates of inflation render obsolete many of the traditional forms and terms of lending and deposit-taking, and institutions should be given the opportunity to adapt. Certainly the increased popularity of the variable rate mortgage at state-chartered savings and loan associations in California is good evidence of a move toward adaptation, as is the emergence over the past ten years of the private mortgage insur-

ance company that facilitates low down payment, conventional residential mortgages.

It is clear that the low down payment, insured, conventional mortgage addresses part of the question posed by Professor Rosen: How do we reflect anticipated inflation rates in terms of conventional mortgages other than in the interest rate? In this case, the insurer, who generally insures only the top 10–20 percent of the mortgage, anticipates that in the event of default he will be protected to some degree by a rise in home prices.

However, it is difficult to see how any lender will be attracted to Professor Rosen's proposal to, in effect, immediately permit the homeowner to realize a presumed increase in the value of his property. First, the increase is only "presumed" because it is based on one-half the rise in the Consumer Price Index (national? SMSA?). Furthermore, while a reasonable presumption can be made that home values over a region will rise at some fraction of the CPI, mortgages are site-specific and tied, ultimately, to an individual property. A new highway, a public housing project, and a factory closing—not uncommon developments in lower income areas—can significantly deflect trends in single-family home prices away from overall CPI trends.

In addition, I am disturbed by the fate of a distantly related proposal—which was adopted by some euphoric college endowment managers in the late 1960s—to treat capital gains on common stock as ordinary income. Since equity prices in the late 1960s were considered by some to be on a forever upward trend, surely some fraction of capital gains could be used to meet normal operating expenses. If the CPI should ever fall and the equity-adjusted mortgage mechanism is symmetrical, major hardships are implied for this set of homeowners. It would be helpful to have Professor Rosen spell out in considerably more detail his passing reference to "some type of co-insurance scheme" that is supposed to handle the above issues.

Second, since principal repayments to the lending institution are presumably reduced in the early years of mortgage, the institution's cash flow and its ability to make new loans in a period of inflationary pressures are sharply curtailed unless, of course, the total flow of funds to residential mortgages is to be increased by other unspecified (government?) actions. Further discussion of this issue beyond the three short sentences acknowledging its existence would also be welcomed.

Finally, concerning Professor Rosen's proposal for special IRA-type savings accounts to be used for down payments by first-time homebuyers, one can admire the scheme for its relative simplicity and directness without endorsing it. Not only has Canada tried this particular device, but many other countries—through reduced tax rates on interest earned on

thrift deposits, for example—have also tried a similar approach. However, viewed in the broader context of tax loopholes and their contribution to federal government deficits—with their not inconsequential ultimate impact on inflation—I would much prefer a consistent, coordinated attack on the underlying problem, with its universally admitted pernicious effects on homebuying and residential construction patterns.

NOTES

1. Congressional Budget Office, *Home Ownership: The Changing Relationship of Costs and Income, and Possible Federal Roles*, January 1977; Bernard J. Frieden and Arthur P. Solomon, *The Nation's Housing Needs: 1975–1985* (Cambridge, Mass.: Joint Center for Urban Studies of MIT and Harvard University, 1977); John C. Weicher and John C. Simonson, "Recent Trends in Housing Costs," *Journal of Economics and Business* 27 (Winter 1975): 177–185.

Comment *by* *Jack Robinson*

Over the past ten years or so, it has become apparent that the traditional fixed-rate, level payment mortgage has failed to meet the needs of many borrower and lender groups. The major underlying cause for this growing gap between borrower-lender requirements and available mortgage financing mechanisms has, of course, been the highly inflationary economic environment of the past decade. From the standpoint of numerous borrowers, particularly young families just beginning to enter the housing market, tremendous increases in homeownership costs have raised mortgage and other homeownership obligations well beyond financial abilities. From the standpoint of lenders, most notably thrift institutions with borrow short, lend long balance sheet structures, the extension of long-term mortgage credit at fixed current rates has increased their vulnerability to earnings and liquidity pressures during periods of sharply rising interest rates. These interest rate increases have occurred frequently in response to the adoption of stringent monetary policies by the Federal Reserve in an effort to control inflationary pressures.